

Expert Report of Peter S. Fader, Ph.D.

I. Background and Qualifications

1. I am a tenured Associate Professor of Marketing at the Wharton School of the University of Pennsylvania. I received a Ph.D. in marketing, a S.M. in management science, and a S.B. in mathematics from the Massachusetts Institute of Technology. I have published numerous journal articles and book chapters on a variety of marketing and applied statistics topics. I am on the editorial board of *Marketing Science*, *Journal of Marketing Research*, and *Marketing Letters* and am chair-elect of the Section on Statistics in Marketing of the American Statistical Association. I received the Paul E. Green Award in 1997 for the best journal article published in the *Journal of Marketing Research* in 1996, and have received several teaching awards from the Wharton School.
2. My research focuses on using data generated by new information technology, such as retail point-of-sale scanners and the Internet, to understand consumer preferences and to assist companies in fine-tuning their marketing tactics and strategies. My recent projects include predictive and explanatory models for electronic commerce (e.g., forecasting models for website usage and purchasing behavior), consumer packaged goods industries (e.g., models of new product trial and repeat purchasing patterns), and the music industry (e.g., understanding the patterns of song movements within the Billboard "Hot 100" chart).
3. Further information about my professional activities is in my curriculum vitae, attached as Appendix A to this report. I have not testified in deposition or at trial in the last four years. I am being compensated at my usual hourly rate of \$600 for the time spent working on this matter.

II. Scope of Work

4. I have been asked by counsel for Napster, Inc. to study the use of Napster's file-sharing platform and its impact on music purchasing. As part of my research, I was also

asked to design and implement a survey to learn more about the attitudes and behaviors of consumers who download music using distributed file-sharing programs, including Napster. Finally, I have been asked to review the reports submitted by Dr. E. Deborah Jay, Mr. Charles Robbins, and Mr. Michael Fine and to provide my assessment of their validity, methodologies and conclusions.

5. A list of the materials I have considered in forming my opinions in this case is attached as Appendix B.

III. Executive Summary

6. The available evidence provides overwhelming support for the contention that Napster is beneficial to the music industry. Market-level data show record-breaking CD sales. Plaintiffs attempt to counter that evidence with the declaration of Mr. Charles Robbins and Mr. Fine's report. Mr. Robbins insinuates that Napster use is harming his record sales. However, his deposition testimony reveals a number of reasons, unrelated to Napster, that appear to be responsible for the declining performance of his record store.

7. The evidence and analysis presented by Mr. Fine also distort the truth about recent music sales. His report, purporting to show that Napster reduces retail CD sales to college students, provides no reliable evidence that Napster is the cause of any alleged declines.

8. At the individual consumer level, virtually all the published studies provide evidence that consumers' use of file sharing platforms stimulates more CD sales than it might displace.

9. Contrary evidence is presented in the Jay survey of college students which is flawed in execution and misleading in interpretation. Jay arrives at her conclusions by subjectively interpreting responses to open-ended questions in a way that aggressively and relentlessly favors the plaintiffs in this litigation. When properly interpreted, her data actually provide additional evidence that Napster use has a net positive impact on users' purchases of music.

10. By focusing on college students, Dr. Jay's study, along with Mr. Fine's report, cannot provide an accurate picture of the overall impact of Napster. Dr. Jay admits that she failed to test whether or not her results can be generalized beyond college students using Napster. Several sources, including my own study, show that college students are actually a minority of Napster's users. Further, the results of my survey clearly demonstrate that Napster's impact on college students differs from its effect on non-students.

11. In addition to examining evidence from published reports, I designed and oversaw the implementation of a survey, conducted by Greenfield Online, to measure the attitudes and behaviors of those consumers who have utilized distributed file-sharing programs or downloaded music from the Internet. I find that since using Napster, a greater share of consumers have increased their purchasing of CDs than have decreased their CD purchases. Based on the results of my research, I conclude that Napster is currently contributing, and will continue to contribute for at least the next six months, to the positive growth of music sales.

12. The net positive impact of Napster is not surprising in light of the substantial evidence on how consumers are actually making use of Napster. The data reflect that, among Napster's multitude of uses, consumers are frequently utilizing the platform to sample new music before making their purchase decisions. In addition, a majority of users have used Napster as a convenient and efficient tool for "shifting" music the user already owns to other playback devices.

13. Aside from these two uses, Napster incorporates a number of additional features into its platform that are valued and exploited by its users. These include a community forum with chat and instant messaging capabilities and a new artist search function for users interested in learning about new artists that, in turn, helps those artists gain exposure to music listeners. Napster also facilitates promotional activities by established bands, such as the authorized distribution of concert tapes, and incorporates an internal player that allows users to organize and play their audio files. The innovative technology promulgated by the Napster platform also offers exciting opportunities and applications

outside the realm of music, such as the those suggested for use in the Human Genome Project.

IV. Introduction

14. My report begins by summarizing the available evidence about Napster's impact on music sales. I start by reviewing market-level evidence on trends in CD sales including Mr. Robbins' questionable declaration and Mr. Fine's flawed study of sales to college students. Then I examine the results of published surveys in which consumers report on the impact of Napster and other file-sharing platforms on their music purchases. I review the biased results of Dr. Jay's own survey of college students for this litigation and present the results of my own study.

15. I continue with a presentation of evidence on how Napster is being used and the relationship between its use and the results on impact. I describe numerous uses of Napster unrelated to uses that might be construed as displacing CD sales. Those uses, as they relate to music, include sampling, space-shifting, community-building, learning about new artists, promoting established artists and playing and organizing digital music files. I report evidence on the prevalence of these uses and their relationship with user reports of Napster's impacts that come from my study. Finally, I also explore briefly some potential uses of Napster that extend beyond the music industry.

V. The Impact of Napster

16. I have examined the short-term effects of Napster on music sales. In particular, I have attempted to determine what impact, if any, Napster has had, and what impact the continued availability of Napster may have during the period before the trial, to presumably take place early next year.

17. Plaintiffs' legal pleadings and expert reports suggest that the use of Napster displaces music purchases. On the other hand, recent public press, studies and surveys

suggest that the use of Napster more likely increases users' purchases of music. For example, Walter Mossberg, the Wall Street Journal's highly respected personal technology columnist, commented that, upon trying Napster, he "rediscovered artists and songs that spurred old memories and prompted [him] to buy five CDs and a DVD."¹ Hence two hypotheses about the impact of Napster can be framed: Napster *displaces* music sales or Napster *stimulates* music sales.

18. These hypotheses can be examined from two different perspectives – from the viewpoint of aggregate (market-level) behavior and from the viewpoints of surveys of individual users. Regardless of which perspective is taken, however, the conclusion is identical: Napster has contributed to a boost in industry sales and is likely to continue to do so.

19. My analysis of the market-level and survey evidence reveals that consumers continue to create a high level of demand for music products, both in the CD and downloadable formats. My review of the recent public press, studies, and surveys, as well as the survey created and implemented under my direction, supports my conclusion that Napster and other similar platforms are contributing to the growth in demand and sales.

A. Market-Level Evidence on Impact

20. The most obvious assessment of market-level performance can be seen in published reports about recent increases in industry sales. According to data from SoundScan, Inc., retail album sales are up 8 percent so far this year.² CD shipments are expected to grow to more than one billion by the end of 2000, compared with a total of 940 million in 1999.³ "Over all, the industry is on track to ship more than \$15 billion in CD's, DVD's, and even vinyl albums this year—double the level of a decade ago."⁴

¹ Mossberg, Walter, "Behind the Lawsuit: Napster Offers Model for Music Distribution," Wall Street Journal, May 11, 2000, p. B1.

² Berenson, Alex and Richtel, Matt, "Music Industry Heartbreakers, Dream Makers," The New York Times, June 25, 2000. <http://www.nytimes.com/library/financial/sunday/062500biz-berenson.html>.

³ Ibid.

⁴ Ibid.

21. Citing these same SoundScan sales figures, a recent *Wired News* feature notes that "statistics show that people are buying more albums than ever."⁵ The president of the National Association of Retail Merchants is quoted in the same article as saying that "the SoundScan numbers do a lot to back up what retailers have known for some time—that people are still going out to the store to buy the music that they like."⁶ Indeed, Paul Viddich, the executive vice president of Warner Music, who has submitted a declaration on plaintiffs' behalf, said that people who fear the rise in websites offering free digital music downloads have "misunderstood the business of music." "People do like CD's," he said. "They continue to buy about 900 million CD's every year in this country. I don't think people are going to change their behavior dramatically. They're going to continue to do what they've done, and they're going to do new things."⁷

22. Industry insiders comment that the current growth in sales is largely due to Internet-based promotion efforts.⁸ Benchmarks for sales success are being obliterated by artists such as Eminem, Britney Spears and 'N Sync.⁹ These artists are highly popular among the demographic groups (i.e., high school and college students) who plaintiffs implicate as the most active users of Napster and kindred technologies. Examples of big-name artists such as these enjoying such resounding sales success are hard to reconcile with any claim that Napster (and other file-sharing programs) are harming record sales.

B. Mr. Robbins' Declaration

23. To counter the market-level evidence of substantial increases in music sales, plaintiffs offer an anecdote in the form of a declaration by Mr. Charles Robbins, a Syracuse, New York record store owner. Robbins' retail establishment, Oliver's, is located in close proximity to the campus of Syracuse University (SU). According to his

⁵ King, Brad, "Despite 'Piracy,' CD Sales Up," *Wired News*, April 24, 2000. <http://www.wired.com/news/business/0,1367,35848,00.html>.

⁶ Ibid.

⁷ Berenson, Alex and Richtel, Matt, "Music Industry Heartbreakers, Dream Makers," *The New York Times*, June 25, 2000. <http://www.nytimes.com/library/financial/sunday/062500biz-berenson.html>.

⁸ King, Brad, "Pop Goes The Music Record," *Wired News*, June 2, 2000. <http://www.wired.com/news/business/0,1367,36662,00.html>.

⁹ Ibid.

Strauss, Neil, "Teeny-Boppers Shatter a Record," *The New York Times*, May 25, 2000.

declaration, Robbins noticed a marked decline in his store's sales "beginning with the late summer of 1999," and sales did not improve in the fall of the same year.¹⁰ His declaration implies that the availability of Napster is the sole reason for his recent experience. Such an inference can be drawn, for example, from his statement that "Napster has made me very pessimistic about the ongoing viability of Oliver's."¹¹ However, Robbins offers no scientifically valid evidence that Napster is responsible for a decline in his sales; in fact, his deposition testimony reveals that several other factors are more likely responsible.

24. First, Robbins acknowledges in his declaration that he faces competition from several other retail record stores, and that they are "often selling [records, CDs and cassettes] at retail at prices lower than [he] can acquire them wholesale."¹² He confirms in his deposition that he faces competition from Best Buy, The Sound Garden, Record Town, Borders, Wal-Mart, and Media Play, all of which are within 5 miles of the SU campus.¹³ Most purchases of music, Robbins admits, are of new releases and "hits," but Oliver's sells this type of music at a higher price than most of his competitors.¹⁴ Price-sensitive consumers, including students, are likely to make their purchases at locations with lower prices.¹⁵

25. Second, while Oliver's continues to offer CDs, the format of choice for the vast majority of consumers, most of the CDs he offers are used. More importantly, at the end of 1999, Robbins shifted the focus of the store's sales efforts to vinyl records.¹⁶ Given his claim that most students listen to music on their computers or in their cars, the vinyl format seems highly incompatible with the market demand he faces.¹⁷

¹⁰ Declaration of Charles Robbins, June 2, 2000, pp. 1 – 2.

¹¹ Ibid., p. 3.

¹² Ibid., p. 1.

¹³ Deposition of Charles E. Robbins, June 28, 2000, pp. 41 – 43.

¹⁴ Ibid., pp. 47 – 48.

¹⁵ In fact, Mr. Robbins describes incidents in which students have, on more than one occasion, come to his store and asked, "why are your prices so high?" Ibid., pp. 52, 57.

¹⁶ Ibid., p. 17.

¹⁷ Ibid., pp. 82 – 83.

26. Third, Robbins claims that he has observed students using Oliver's listening stations to identify tracks that they then download from Napster. He believes they pursue this strategy "so they do not have to waste time downloading songs from Napster that they may not want." This conclusion does not square for three reasons. First, Robbins admits in his deposition that he bases this belief on the alleged statement of one female student. Second, he admits that the conclusion he bases on her statement is the result of "a slight conjecture there on my part." Third, although he claims students do not want to waste time downloading songs from Napster, he testifies that he timed the download of a seven minute song using Napster by a Syracuse University student, and the download took thirty-five seconds. In contrast, he admits that it would take a student between five and twenty minutes to walk to Oliver's from the University campus.¹⁸

27. Finally, the evidence offered most prominently in his declaration to establish the validity of the claim that Napster is somehow responsible for a decline in Oliver's sales is his comparison of sales figures. Robbins' declaration is silent on his sales figures for the months from August 1999 to November 1999. He selectively chooses each of the months from December 1999 to April 2000 to compare with previous years' sales figures. As it turns out, the months he analyzes coincide with his change to the vinyl format. More importantly, they are exactly coincident with a change in the location of his store – a factor that is, alone, likely to have a significant impact on his business. Prior to the move in November 1999, Oliver's was located for seven years in an area with "a lot of foot traffic," on the main university "drag," at street level, situated among a number of other retail establishments.¹⁹ However, Robbins then moved the store to a location that had been vacant for six to eight months, is exposed to less pedestrian traffic, is below street level, and is located on a street with no other retail storefronts.²⁰

28. Robbins' declaration does not offer a single piece of evidence causally linking the availability of Napster to a decline in his store's sales. He admits as much, saying that his suspicions may be "slight conjecture." Further, the evidence he does offer can easily be explained by his inability to compete with lower-priced music offerings from the

¹⁸ Ibid., pp. 100 – 101.

¹⁹ Ibid., pp. 107 – 110.

number of other area retailers, his change in selection from new release CDs to vinyl records, and the change from a prominent university location to an inconspicuous storefront. One cannot assess the impact of Napster on music purchases by the presentation of one misleading example. To more accurately assess Napster's impact, I find it prudent to examine the breadth of market-level data and survey results that are available.

C. Mr. Fine's Study

29. Again, despite market-level evidence suggesting that music sales are stronger than ever, Michael Fine, CEO of SoundScan, also submitted a declaration purporting to show that "online file sharing has resulted in a loss of album sales within the college market."²¹ Mr. Fine reaches that conclusion based on his evidence that while national retail music sales have been growing between the first quarter of 1997 and the first quarter of 2000, sales at music stores within one mile of college campuses have declined. Further support is taken from the study's findings that retail sales of CDs have fallen even more sharply near the "Top 40 Wired Colleges" and colleges that have banned Napster. Several significant flaws with Fine's analysis render his entire report meaningless.

30. First, because it excludes music sold online, Fine's study has no hope of correctly measuring changes in music sales over time.²² Fine has not attempted to determine the extent to which online music purchases by college students have replaced their purchases at retail.²³ Without accurately capturing changes in music sales over time, Fine cannot say anything about the impact of Napster use on those sales. Setting that flaw aside, the report does not speak to the impact of Napster on music sales because Fine's analysis does not causally link the alleged declines in retail sales to the timing of the rise of Napster use.

²⁰ Ibid., pp. 95 - 98, 107 - 108.

²¹ Expert Report of Michael Fine, June 10, 2000, p. 1.

²² Fine's methodology for measuring trends in retail sales near college campuses may itself be flawed, possibly resulting in an understatement of retail sales growth in those locations. Fine excludes from his three college samples stores that enter the SoundScan survey data after the first quarter of 1997. If newer stores in these college markets are growing faster than the older stores he tracks in his sample, Fine's measure of retail sales growth will be understated.

²³ Deposition of Michael Fine, June 28, 2000, p. 13.

31. Evidence on the growth of online music sales provides a convincing explanation for the declines in retail music sales that Fine reports.²⁴ Online music sales have been growing rapidly in the last several years. Amazon.com's sales of CDs increased 136% between 1998 and 1999 while online music retailer CDNow's sales increased 99% from first quarter 1999 to first quarter 2000.²⁵ The failure to consider online CD sales is an even greater deficiency when considering sales at stores near the Top 40 Wired schools and schools that have banned Napster. In his deposition, Fine states that "Internet sales among college students should be similar between the three groups that we looked at."²⁶ However, for example, students at the "Top 40 Wired" schools are likely to enjoy far greater Internet access than the population of all college students, having amenities such as a higher number of computer terminals per student, more computers available 24 hours a day, and a higher percentage of undergraduates with wired dorm rooms.²⁷ It is hard to believe that greater Internet access does not translate into more rapidly growing Internet use, including use of the Internet for purchasing music. This is completely consistent with Fine's results.

32. In deposition, Fine emphasizes the importance of his findings at the "Top 40 Wired" colleges and colleges that have banned Napster as compared to all colleges in reaching his conclusion.²⁸ However, he fails to test whether or not the differences he cites are statistically significant. This failure to test is a substantial shortcoming of Fine's analysis especially in light of the poor coverage the SoundScan data provide in his college markets. Relying on a small number of observations to estimate CD sales growth for the various college samples increases the variability of his estimate and makes it unlikely to find any statistically significant differences across the samples. His analysis includes sales from only 2,099 stores near the 3,454 colleges identified. Among the 64 schools that he identifies as having banned Napster, he has data on sales at only 48 stores

²⁴ Mr. Fine himself admits that Internet music sales are growing. Deposition of Michael Fine, June 28, 2000, p. 48.

²⁵ Amazon.com's fourth quarter music sales increased 136% to \$78 million between 1998 and 1999 while CDNow's first quarter revenues in 2000 were up 99% over the previous year at \$43.6 million. King, Brad, "Napster: Music's Friend or Foe?" Wired News, June 14, 2000. <http://www.wired.com/news/print/0,1294,36961,00.html>.

²⁶ Deposition of Michael Fine, June 28, 2000, p. 14.

²⁷ See <http://www.zdnet.com/yil/content/college/colleges99/chartkey.html>.

near 31 of the schools. Near the "Top 40 Wired" colleges, he studies only 44 stores. This analysis also includes schools that have no stores within one mile of the campus.

33. Setting aside the fact that Fine has failed to prove the existence of any decline in CD sales to college students, Fine's evidence does not show that Napster use has caused any alleged declines. In his deposition, Fine admits that he has not isolated the impact of Napster from the impact of more general trends in downloading MP3s.²⁹ Fine's SoundScan data first show a decline in retail CD sales, in all college stores and at the top 40 wired schools, starting in Q1 1999.³⁰ However, Napster did not even exist in Q1 1999. Clearly, any declines observed before Napster's release are caused by factors other than Napster, such as increases in online sales. In fact, for stores near the top 40 wired schools, the decline in sales relative to the change in National sales, has actually *slowed* during the time in which Napster has been available.

34. Fine's results for schools that have banned Napster seem to contradict rather than support his hypothesis about the impact of Napster, thereby providing additional evidence that he has failed to control for all the factors unrelated to Napster that are affecting music sales. Fine claims that Napster use was particularly heavy at campuses that eventually banned its use.³¹ Rather than looking for larger declines in CD sales around campuses that have banned Napster than around other campuses, Fine should have tested whether CD sales at schools that have banned Napster increased after students stop using the file-sharing program. The fact that retail CD sales have experienced allegedly larger declines near schools that have banned Napster suggests that either online sales are even more prevalent among those students or that Napster use actually promotes CD sales by facilitating sampling.

35. Finally, plaintiffs try to leverage Fine's results with respect to college students into a conclusion about Napster's entire impact. Plaintiffs cannot use Fine's results with

²⁸ Deposition of Michael Fine, June 28, 2000, p. 14.

²⁹ Deposition of Michael Fine, June 28, 2000, p. 68.

³⁰ For stores near schools that have banned Napster, the decline starts even earlier as sales grow more slowly than National sales starting between Q1 1997 and Q1 1998.

³¹ Several colleges that banned Napster may have done so because of lawsuits (or the threat of lawsuits) rather than in response to problems with heavy Napster use. See "Two Universities Block Access to Napster," The New York Times, April 21, 2000.

respect to college students to reach a conclusion about Napster's entire impact. Estimates of the percentage of Napster users that are not college students include the results of the Pew Internet & American Life Project's Internet Tracking Report which shows that more than half of Napster's users are at least 30 years old.³² This is consistent with the usage patterns observed in my study. Clearly any estimate within this range refutes plaintiffs attempts to paint Napster as a program used exclusively by college students. Due to this sum of flaws, Fine's report does not and cannot provide any valid evidence that Napster use is associated with any alleged declines in CD sales.

D. Survey Evidence on Impact

36. In addition to evidence on the overall growth of CD unit sales and anecdotal evidence suggesting that Napster has had a directly positive net impact on music purchases, a multitude of recent studies reported in the media support the same conclusion. Studies by Digital Mogul and CENTRIS, Greenfield Online QuickTake, CyberDialogue, the Digital Media Association, *Rolling Stone*, and University of Southern California (USC) create a virtual chorus of data refuting plaintiffs' finding of substantial negative impact on music purchasing. The results of these studies are summarized in Exhibit 1. To the best of my knowledge, this body of work comprises every study (outside of those that were conducted as part of this litigation) that offers any conclusions about Napster's impact on music sales.³³

37. A survey by Digital Mogul and CENTRIS, released in December 1999, found that almost half of respondents felt that sampling a digital audio track increases the likelihood

³² "13 million Americans 'freeload' music on the Internet; 1 billion free music files now sit on Napster users' computers," Pew Internet & American Life Project, Internet Tracking Report, June 8, 2000. <http://www.pewinternet.org>.

³³ I have also examined other studies on downloadable music that do not specifically address Napster's impact on music sales, e.g. Webnoize Research's Spring 2000 "Napster University" study, Pew Internet and American Life Project's "Internet Tracking Report," Greenfield Online's "e-Merging Music" and "e-Merging Music II" studies, and IDC's report on "Music Downloads and Consumer Perception."

of purchasing the entire CD on the Internet. Additionally, 55% said that track sampling increases their likelihood of going into a retail store to purchase the CD.³⁴

38. Of the respondents to a Greenfield Online QuickTake.com survey, 38% said that downloading digital music will cause them to buy more CDs while 46% said they expect to buy the same number of CDs.³⁵

39. A Cyber Dialogue analyst stated that a recent study by the firm dispels the music industry's fears that the Internet could prove to be damaging. Rather, she said the Internet more accurately "grows the demand for the music market."³⁶ A study by her firm found that, of those music site visitors who download music files, 29% purchase more music as a result, 49% purchase the same amount, and an additional 14% say that their awareness of and interest in new artists and music styles has increased.³⁷ These results come from Cyber Dialogue's Cybercitizen Entertainment program, which focuses on consumers' use of a variety of entertainment content including Music, TV, Movies, Sports and Games.³⁸

40. A Digital Media Association study provides additional evidence that Internet streaming and downloading of music increases CD sales. The results of the study, compiled by Yankelovich Partners, were recently presented to the House Judiciary Subcommittee on Intellectual Property. For 59% of respondents, hearing a single online has prompted them to buy the album. Almost one-third of those who download say it makes them more likely to buy music while 57% say their buying habits are not affected.³⁹

41. Of respondents to a Summer 2000 *Rolling Stone* readers survey, 90% buy at least as many CDs now as before free music was available on the Internet. 36% say they buy

³⁴ "Sampling Music Singles Online Increases Likelihood of Purchasing CDs - Especially at Retail," Digital Mogul and CENTRIS Press Release, December 14, 1999.

³⁵ Greenfield Online QuickTake survey, May 4, 2000.
http://beta.greenfield.com/pages/go_article.asp?AID=1293&SS=music.

³⁶ Hu, Jim, "Net music fans would pay for albums, study says" CNET News.com, June 7, 2000.
<http://www.cnet.com/news/0-1005-200-2033622.html?tag=st>.

³⁷ Results provided by Cyber Dialogue from its 1999 Cybercitizen Entertainment Survey.

³⁸ See <http://www.cyberdialogue.com/products/isg/cce/index.html>.

³⁹ "Web Music," DiMA web site. http://www.digmedia.org/whatsnew/web_music.html.

more music because of Napster and other MP3-download sites. Consistent with those results, 83% said they had never decided not to buy a CD because they got it free online. 22% of those who download music once a week said they usually buy a CD after listening to an artist's music on the Internet.⁴⁰

42. Researchers at USC recently surveyed USC's student population and concluded that "MP3 usage among students has not significantly reduced their CD consumption patterns. Most students (63%) who download MP3s say they are still buying the same number of CDs; 10% of MP3 users say they are buying more CDs. What's more, 39% of students who download MP3s say that after listening to recorded music in MP3 format, they often buy CDs containing that music."⁴¹

43. The responses to my survey (discussed in more detail below) are highly consistent with this set of conclusions showing that Napster has a direct and net positive influence on music purchases. The use of Napster to download files is more likely to have increased music purchases than to have decreased music purchases, with 28.3% of users who have downloaded files with Napster saying that their music purchases have increased since they began using the software. This is in contrast to the 8.1% who say that their music purchases have decreased.⁴²

44. This variety of data, examples, and studies serves as evidence that Napster is *not* "harming sales of CDs" and Napster users are *not* "buying significantly fewer CDs as a result of their Napster use."⁴³ When taken together, all of the studies, other than Jay, conclude that 73% to 92% of those consumers using Napster purchase the same amount of music or more music now than they did before Napster was available.

⁴⁰ "RS Readers Poll: Music and the Internet," Rolling Stone, July 6-20, 2000, p. 45.

⁴¹ Latonero, Mark. "Survey of MP3 Usage: Report on a University Consumption Community," The Norman Lear Center, Annenberg School for Communication, University of Southern California, June 2000, p. 2. It is true that 28% of USC students who download report purchasing fewer CDs since they began downloading MP3s. This result is less surprising when one considers that the study surveys only college students while the other studies survey a more general population. As described in more detail below, many Napster users are not college students, and college students and non-college students use Napster in different ways.

⁴² Fader Study, question #17.

⁴³ Notice of Joint Motion and Joint Motion of Plaintiffs For Preliminary Injunction, p. 26.

45. Finally, there is nothing in the materials I have examined to indicate that these patterns of attitudes and behaviors are likely to change in the next six months. Since the introduction of Napster and the dozens of other distributed file-sharing programs and MP3 search websites, consumers have continued to purchase CDs in record numbers. There is no evidence from which one could conclude that this pattern will change with the continued operation of Napster.

E. Jay Survey

46. In a declaration submitted by plaintiffs, Dr. Deborah Jay presented evidence from a survey of college students that purports to show that Napster use displaces CD sales for many Napster users. The Jay Study is seriously flawed in its analysis and interpretation. In this section I address the errors in Jay's choice of sample and subsequent analysis. The key to understanding why Dr. Jay's results are so different from other studies is to separate out Dr. Jay's subjective and biased *interpretations* of the data from the data itself. This is essential as most of Jay's main conclusions rely on her interpretation of respondents' answers to open-ended questions. As I will show below, Jay's closed-ended questions actually provide strong evidence that Napster use has a positive impact on user's music purchases.

47. Jay's primary conclusion is that "41.0% of Napster users either gave a reason for using Napster or described the nature of its impact on their music purchases in a way which either explicitly indicated or suggested that Napster displaces CD sales."⁴⁴ In this statement she is suggesting that a large fraction of respondents in her subsample indicate that Napster has had a negative impact on their purchase of music. All the other studies that I have reviewed above, including my own survey of Napster users, find that the neutral and positive effects of the availability of downloadable music singles swamp any negative effect. None of these studies finds a negative effect anywhere in the range of what Jay reports here.

⁴⁴ Report of E. Deborah Jay, Ph.D., June 10, 2000, p. 34.

E.1 Jay Samples Only College Students

48. The difference in Jay's conclusion is less surprising once you note that she chooses to survey only college students who have used Napster and chooses to report results for only those college students that have downloaded MP3 files using Napster. This is clearly a limited subsample of all Napster users, and not representative of Napster users as a whole.

49. Napster users are not all college students. The evidence that Napster users are largely non-students comes from the Pew study, Cyber Dialogue, and my own survey. The Pew study found that just 37% of those that download free music from online sources are students, and more than half of all downloaders are over the age of 30.⁴⁵ Cyber Dialogue's CyberBits Trend Report details similar usage statistics, with 76% of online downloaders over the age of 23 and more than half (53%) 30 years or older.⁴⁶ Finally, of the respondents to my survey that indicated that they have downloaded using Napster, 76.5% were not college students.⁴⁷

50. Moreover, Napster users who are college students differ in significant ways from the many Napster users who are not college students, according to the results of my study.⁴⁸ While college students are similar to non-students in that a greater percentage report increased CD purchases since using Napster than report decreases, the effect is not as strong. College students are less likely to say that their CD purchases have increased since using Napster and more likely to say that they have decreased.⁴⁹ 24.3% of the college students responding to my survey said that their music purchases have "increased somewhat" or "increased a lot" since they started using Napster compared to 29.2% of non-students. 13.7% of college students said that their music purchases have "decreased somewhat" or "decreased a lot" since they started using Napster compared to 6.4% of

⁴⁵ Pew Internet & American Life Project, "Internet Tracking Report," June 8, 2000, p. 4.
<http://www.pewinternet.org>.

⁴⁶ Cyber Dialogue, Inc., "Cybercitizen Entertainment Continuous Advisory Service: CyberBits Trend Report," No. 1, 2000.

⁴⁷ Fader Study, questions #26 and #27.

⁴⁸ I define college students to include part-time and full-time college and graduate students.

⁴⁹ The difference in their responses is statistically significant at the 1% level.

non-students.⁵⁰ Thus, the non-college Napster users ignored by Jay differ substantially from the college student users that Jay focuses on exclusively, making it inappropriate for Jay to draw conclusions about the impact on music purchases of Napster use. Dr. Jay herself testified in her deposition that her survey is projectable only to college students, that she did no analysis of non-college Napster users, and that she did no testing to determine if the results from her subsample would yield the same information as would a survey of all Napster users.⁵¹

51. In addition, the results Jay reports for her college sample relate only to the responses of those 500 college students who have downloaded using Napster, ignoring the 103 individuals that have used the program but have not downloaded files using Napster. As it turns out, the 103 users who do not download are quite unlike those users who do download.⁵² See Exhibit 2. Jay's report is silent on what the logic is for failing to examine and report the responses of 17% of the people for whom she collected full information.

E.2 Jay Subjectively Interprets Answers to Open-Ended Questions

52. Jay reports that 41% of her sample either "explicitly indicated or suggested that Napster replaces CD sales." The design of her survey requires her to take a very convoluted path, replete with subjective interpretation, to arrive at this statistic. To be included in the 41%, a respondent had to answer one of the two following sets of open-ended questions: (1) "What are the main reasons you use Napster?" and "Are there any other reasons why you use Napster?" (the "Open-Ended Use" questions) or (2) "In what way or ways has Napster had an impact on your purchase of music?" and "Has Napster had any other impact on your purchases of music?" (the "Open-Ended Impact" questions).

⁵⁰ Fader Study, question #17.

⁵¹ Deposition of E. Deborah Jay, Ph.D., June 23, 2000, pp. 24-25.

⁵² For example, although Jay interprets her results to conclude that 34.4%, when asked the main reason they use Napster, report that they "don't have to buy CDs, can get free music; can get any song or the songs I want; can get music I don't have; it's better than a CD; you don't need a stereo or CD player," only 8.7% of non-downloaders fit this category. See Exhibit 2 for a comparison of the two subsamples.

53. Because she relies on open-ended questions, Jay must exercise significant subjective interpretation in converting literal answers (“verbatim”) to her questions about use and impact into a quantitative measure of impact. Jay’s manipulation of the verbatims involves four steps:

- *Step One:* Jay asks open-ended questions and records verbatim answers.
- *Step Two:* Jay interprets the verbatims and assigns them to categories.
- *Step Three:* Jay aggregates these categories into groups.
- *Step Four:* Jay decides what inclusion in each group implies about a respondents’ likelihood of buying less (or more) music.

Many of the flaws in Jay’s analysis can be traced to the inherent ambiguity of many of the verbatims. For example, “I can find the songs that I want” can be interpreted as consistent with previewing and buying more, previewing and buying less, listening to your own CDs uploaded in a mix with easy access, or listening to things that one would not have bought in the first place. Jay compounds the ambiguity of the verbatims by aggressively biasing her analysis to indicate displacement. Whenever there was an ambiguity that could be consistent with both more purchases, less purchases, or no change in purchases, she considered it to either display displacement or to be benign. In some cases this was absolutely egregious; in other cases, just aggressively biased. I describe each of the steps Jay followed in manipulating the verbatims in more detail below.

Step One. Jay asks open-ended questions and records verbatim answers. The bias in Jay’s results begins in the phrasing of her Open-Ended Use question, which is designed in such a way that it actually makes it less likely that one will find direct evidence of an increase in music purchases due to Napster usage. Given the phrasing of the question, people are likely to answer the question less directly if Napster causes them to buy more music. If someone is buying more music due to Napster, they will most likely not say “The main reason I use Napster is to buy more music,” because a respondent does not buy music from Napster. Rather, the respondent will more likely describe the

functionality of Napster – which is free – that he enjoys, which functionality may actually lead him to buy more music. For example, he may say, “I preview music” or “I find songs I like” or “I find different new music.” In each of these cases, utilizing Napster for these reasons may actually stimulate a respondent’s purchase of music. If, however, someone is buying less music due to Napster, he most likely will state something direct about not buying CDs, such as “So I don’t have to buy CDs” or something about the functionality, such as “It is free and I find the songs I like.” So Jay is more likely to find self-reported instances of CD displacement here, and less likely to find self-reported instances of increases in CD purchases. The remainder of the answers are ambiguous, and Jay has to decide what to do with them.

54. *Step Two.* Jay interprets the verbatims and assigns them to categories. For example, in her Table 5, respondent 00060 says that the main reason he uses Napster is “That’s the one I know about” and “It seems we get everything we type in pretty quickly”. He is then coded by Jay as being in 3 categories: “Easy, quick, convenient access to music,” “Can get any song I want, whenever I want,” “It’s the only one I know about.” This step requires substantial subjective judgment on Jay’s part and will be discussed in detail below.

55. *Step Three.* Jay aggregates these categories into groups. In this example, “Easy, quick, convenient access to music” and “It’s the only one I know about” are left as groups to themselves. The category “Can get any song I want, whenever I want” is aggregated with the category “To get the song(s) I want” to make the end group “Can get any songs or the song I want”. This step also requires substantial subjective judgment on Jay’s part and will be discussed in detail below.

56. *Step Four.* Jay decides what inclusion in each group implies about a respondents’ likelihood of buying less (or more music) as a result of using Napster to download music files. In this example, she believes that the category “Can get any songs or the song I want” “suggests” displacement of sales. Thus respondent 00060 is counted in Jay’s 41% as one who indicates that Napster causes displacement of sales.

57. In constructing her 41% displacement number Jay distinguishes between answers that "directly" indicate displacement of music sales versus those that just "suggest" displacement of music sales. Of that 41%, 46.3% are included *only* because they "suggest" displacement of music sales (these respondents do not say anything that Jay codes as directly indicative of displacement of music sales). See Exhibit 3a. The lion's share of the 46.3% come solely from two categories of responses that Jay decides "suggest" displacement of music sales (1) The main reason I use Napster is because "It is free," (2) The main reason I use Napster is so that "I can get any song or the songs I want."

58. Exhibit 4 shows several examples of the types of verbatim answers that Jay chose to include in these two categories. Respondents 33842, 31717, 00060, and 32519 are all included in Jay's displacement figures even though their complete answers suggest *more* music sales, or are completely mute on the point of whether there would be more or less music purchased. A respondent who answered "It is free" or "I can get any song or the songs I want," without giving any other information, clearly cannot be included in a blanket assessment of displacement. Jay *assumes* her result by deciding that all respondents who like Napster because it is free use Napster to displace sales. Those responses could equally mean free sampling, free space-shifting, or, for example, free downloading of Metallica's latest authorized live recording, none of which suggests a displacement of sales. This is actually the question she is supposed to be *testing* with her survey.

59. Jay also ignores information provided by her respondents that would help her quantify displacement (and increased sales). In particular, Jay does not use her respondents' answers to the "Closed-Ended Impact" question: "Since you began using Napster, how much impact, if any, has it had on your purchases of music?" when quantifying displacement. This omission of important information has a substantial effect on her reported results. 51% of the respondents who Jay decided gave verbatims that indicate displacement in their purchases also stated explicitly that Napster has very

little impact on their purchases.⁵³ If I calculate Jay's displacement statistic, but require a respondent to directly indicate displacement in either the Open-Ended Use or Open-Ended Impact questions, and also to state that Napster impacted them some or a great deal, the percent of respondents who indicate Napster displaces CD sales falls dramatically from 41% to 13.6%.

60. The bias in Jay's approach is also evident in her calculation of increased sales. Jay's Table 5 details her conclusion that only 8.4% of respondents indicate that use of Napster has led to increased sales. In marked contrast to finding displacement of sales from "direct" answers to her Open-Ended Impact question and from both "direct" and "suggestive" answers to her Open-Ended Use question, Jay only allows "direct" answers to her Open-Ended Impact question to indicate increased sales. Remarkably, Jay does not interpret a single answer to the Open-Ended Use question from any of the 500 respondents to have "directly" indicated or "suggested" increased purchases. See Exhibit 3b. By contrast, 27.4 percentage points, or 67% of her displacement statistic comes from responses to the same question.

E.3 Jay Ignores Evidence that Users are Sampling

61. Jay states that the focus of the report is to explore "the reasons why college students use Napster, how college students use Napster, and the impact of Napster on their music purchases."⁵⁴ But she focuses solely on those answers that, by her interpretation, "directly show" or "suggest" displacement of CD sales due to the use of Napster. Jay fails to mention the predominant reason stated by her respondents for using Napster. Simply, the respondents like to use Napster to listen to music, preview music, and find new music. Of the entire sample, 68.2% give responses consistent with using Napster to listen to and preview music, and do not provide any response that Jay interprets to be directly indicative of displacement of music sales. See Exhibit 5. Given this result from

⁵³ It is also the case that Jay has included respondents in her final 41% displacement statistic who directly stated that the impact of Napster on their purchases was that they purchase more music. This happens, for example, when a respondent says that the main reason he uses Napster is because it is free, and that the impact of Napster is that he hears music and then buys more. These types of examples account for 4% of the 41%.

⁵⁴ Report of E. Deborah Jay, Ph.D., June 10, 2000, p. 11.

her own data, Jay's final statistic that for 41% of respondents Napster is most likely displacing CD sales (her Table 5) appears misleading at best.

E.4 Jay Incorrectly Assumes CDs and MP3s are Close Substitutes

62. Jay never addresses whether MP3s downloaded from Napster actually are considered by most users to be substitutes for CDs. She does no analysis on this question, and basically assumes they are close to perfect substitutes. As an example of this assumption, she believes that if a respondent says he uses Napster because it is free, this means he will surely buy less CDs. It is simply not accurate to conclude that if a user says he likes Napster because "it is free," that the user is buying fewer CDs, without any other evidence. This user has not said whether he likes free sampling, free browsing, free download of MP3s to listen to at school, free downloading of MP3s to displace the CD purchases he would have made, free downloading of CDs he would not have purchased, etc.

63. In fact, there is evidence to suggest that MP3 files are not viewed by consumers as perfect substitutes. A member of the female trio En Vogue noted that "having a downloaded file in your computer is not the same as having the finished CD with artwork and credits in your hand,"⁵⁵ and a member of the Canadian rock band Kirtie said, "you could download a lot of our music from the Internet and burn it onto a CD, but we think our fans will want to buy our album, too. We've found that even people who listen to us online buy our albums."⁵⁶

E.5 Jay Misuses Closed-Ended Data

64. Finally, Jay mentions several times in her report that a large percentage of her subsample describe Napster as having had an impact on music purchases. She is referring to the answer to a closed-ended question "Since you began using Napster, how much impact, if any, has it had on your purchases of music?" The implication is that this impact is displaced record sales. Setting aside the aforementioned flaws in interpretation

⁵⁵ "The Industry Responds To Napster," Billboard, April 15, 2000.

⁵⁶ Segal, David, "An Upside to Music Downloads," Washington Post, June 22, 2000, p. A01.
<http://washingtonpost.com/wp-dyn/articles/A38086-2000Jun21.html>.

of open-ended questions in her study, an examination of her close-ended questions actually shows that there is a positive correlation between a respondent's reported "impact" of Napster and the percent of downloads that they have purchased. This evidence is directly counter to the idea that impact implies displacement of purchases. To the contrary, the more impact Napster has, the more positive that impact is. See Exhibit 6. In sum, the Jay survey is seriously flawed in its analysis and execution, and cannot be relied upon to conclude that Napster use is associated with a net displacement of CD sales.

F. Fader Survey

65. In order to better understand Napster's effect on music consumers and the music industry, I designed and oversaw the implementation of an Internet-based survey. Specifically, I surveyed U.S. Internet users to discover (a) who is using Napster, (b) how and why people are using Napster, and (c) how, if at all, Napster has altered music consumption patterns. The survey methodology is described in more detail in Appendix C, and a copy of the survey questionnaire is attached as Appendix D.

66. Unlike Mr. Fine and Dr. Jay, I did not restrict participation in my study to college students but let the study results answer the question as to who is using Napster. As it turns out, of the 1,605 respondents to my survey that have used Napster, 18.2% are college students while 76.5% are not students. The remaining respondents indicated that they are high school or "other" students.⁵⁷

67. My survey provides evidence suggesting Napster use is associated with overall increases, not decreases, in CD purchases. I find that, of 1,605 respondents who have downloaded digital music files using Napster, 28.3% say their purchasing of music has increased since using Napster. Only 8.1% say their music purchases have declined while 63.6% state their purchases have not changed.⁵⁸ Further, nearly 70% of the Napster users say they have purchased one or more CDs as a result of sampling using Napster. My

⁵⁷ Fader Study, questions #26 and #27.

⁵⁸ Ibid., p. 17.

results show 46.9% have purchased 1 to 3 CDs as a result of sampling through Napster while 18.3% have purchased 4 to 10 CDs and 4% have purchased 11 or more CDs.⁵⁹

68. These results on the impact of Napster are not surprising given what my survey reveals about how consumers are using the program. Evidence from my study strongly supports the assertion that Napster has many applications that cannot be construed as displacing CD sales, and those applications are being widely enjoyed by Napster users. Further, those uses appear to stimulate interest in and purchases of music. My study identifies uses that include sampling, space-shifting, community-building, creating a platform for emerging artists and facilitating the play and organization of digital music files. Exhibit 7 summarizes, for different groups of Napster users, their response to the question of how their CD purchases have changed since they started using Napster. For users who exploit many of Napster's different features, the extent to which the share of respondents that indicate Napster has a positive impact on CD sales outweighs those that indicate it has a negative effect is even larger than for all Napster users in my survey. This evidence along with evidence on other uses of Napster will be discussed in more detail below.

G. Summary of Evidence on Impact

69. Examined at both the market level and the level of individual consumers, the evidence suggests that Napster's impact on CD sales is positive overall. The role Napster plays in stimulating CD sales appears to dominate any role it might play in displacing CD sales. Music sales are as strong as ever with popular artists continuing to break historical sales records. The reports of Mr. Robbins, Mr. Fine, and Dr. Jay fail to provide any reliable evidence to dispute that fact, let alone to connect Napster to any alleged decline in CD sales. Every reliable and representative published survey of individual consumers shows Napster use, or downloading of digital music files more generally, to cause more consumers to increase their CD purchases than it causes to decrease those purchases. Finally, my own survey corroborates a net positive impact of Napster use. Further, I can

⁵⁹ Ibid., p. 19.

link the positive impact of Napster to many uses of Napster that are unrelated to uses associated with the displacement of CD sales.

VI. The Uses of Napster

70. To understand how Napster and other file-sharing platforms stimulate music sales, one needs only to look more carefully at how consumers are using Napster. Many of the wide variety of uses of Napster that cannot be construed as being related to displaced CD sales actually stimulate consumer exposure to, interest in, and purchases of music. To shed some light on the positive impact that Napster has on music sales, I review several commercially important uses of Napster related to music, followed by a some important current and potential uses that the software offers outside of the music industry.

A. Napster Is Used to Sample Music Before Buying

71. One of the most important uses of Napster is sampling songs in order to make better-informed music purchase decisions. The music industry acknowledges the importance of sampling, using the Internet and other media (primarily radio) to give listeners a taste of new artists and new albums as an enticement for purchases.⁶⁰ As one example, plaintiff EMI noted in a strategy presentation that the band The Offspring distributed some 18 million digital downloads of a recently released single and subsequently sold 8 million copies of the album on which it appears.⁶¹ The unexpected success of the group Kittie provides another illustration of the prevalence and power of digital music sampling. In October 1999, Kittie posted a free download of one of their songs on the Internet. "By the time Kittie's album hit stores in January, pent-up demand helped sell 8,800 copies in a week, propelling it to No. 147 on the Billboard charts. Since then, the record has defied the long odds against pop stardom and is on the verge of

⁶⁰ RIAA, "The Cost of a CD," RIAA Website. <http://www.riaa.com/MD-US-7.cfm>.

⁶¹ EMI strategy presentation, "Recorded Music," October 7, 1999, p. E0834.

selling 400,000 copies . . .” The band’s guitarist recognized that “the Internet for us has been a big help.”⁶²

72. Platforms like Napster expose consumers to a broader range of artists. Consumers have little awareness of (or interest in) record labels, per se, and therefore are unwilling or unable to “surf” from one label’s website to another to look for the music they want. In response to the growing consumer demand for easily accessible digital music, platforms such as Napster provide a more efficient means by which users can find and preview music that might capture their interest.

73. Studies reveal that sampling is an important motivation for downloading digital audio singles and that sampling leads to purchases. According to Greenfield Online’s QuickTake survey, 60% of online users who download free digital music files do so to preview music before buying the CD.⁶³

74. My own survey reveals that sampling is an important use of Napster. More than half of all Napster users (54.7%) always or frequently use Napster for sampling albums that they might consider buying while another 30.2% sometimes sample using the program. Not surprisingly, sampling behavior is positively correlated with music buying. Of those respondents who always or frequently use Napster for sampling, 42.0% have purchased more CDs as a result of using Napster while only 4.7% say they are buying less. The remaining 53.3% say their purchasing has been unaffected.⁶⁴ In fact, as reported above, a majority of respondents explicitly report purchasing CDs as a result of sampling through Napster. These results are not surprising given that 74.0% of Napster users and 65.1% of all survey respondents feel that hearing one or more songs from an album before making a purchase decision is very or extremely important. Another 20.2% of Napster users and 24.8% of all respondents feel sampling before buying is somewhat important.⁶⁵

⁶² Segal, David, “An Upside to Music Downloads,” Washington Post, June 22, 2000, p. A01.
<http://washingtonpost.com/wp-dyn/articles/A38086-2000Jun21.html>.

⁶³ Greenfield Online QuickTake survey, May 4, 2000.
http://beta/greenfield.com/pages/go_article.asp?AID=1293&SS=music.

⁶⁴ Fader Study, questions #14 and #17.

⁶⁵ Ibid., question #5.

B. Napster is a "Space-Shifting" Tool

75. In addition to using Napster as a tool to preview music prior to purchase, users often download MP3 files as a means by which they can listen to music they already own. This practice, known as "space-shifting," involves users downloading music files of songs they already own in the CD, cassette or vinyl formats. Rather than carrying the physical compact disc, many users find it convenient to have access to their music through compressed digital files stored on their computer at home, school or work, or downloaded to one of many MP3 playback devices available as portable, home or car players. In the past, many consumers would accomplish the same goal of creating copies of their music by making audiocassette copies. The MP3 format now allows consumers to listen to songs in a more convenient format without having to carry around a large collection of cassettes or CDs.

76. Napster also allows listeners to create custom mixes of songs from different albums and different formats to enjoy at their convenience. It was also a common practice in the past to create such mixes using audiocassettes. Given the ease and convenience with which users can use Napster, it operates as an innovative tool that expands the uses of consumers' CDs. Creating greater functionality of the music listeners own, in turn, increases the value of that music, benefiting both consumers and the record labels that distribute music.

77. My own study found that more than a third of Napster users (36.3%) always or frequently use Napster to download digital music files of songs that they had previously purchased in another format. Another 34.6% sometimes engage in this practice of space shifting.⁶⁶ The ability to space shift may make CDs themselves more valuable to consumers. Of those who frequently or always use Napster to space shift, 36.9% have increased music purchases since using Napster while 7.2% have decreased purchases.⁶⁷ Space shifting is even more common among heavy users of Napster (those who have downloaded more than 100 files using Napster) than light users (those who have downloaded 25 or fewer files). Of heavy users, 46.0% always or frequently download

⁶⁶ Ibid., question #15.

songs they already own in another format while 28.3% of light users employ Napster to space shift. (84.1% of heavy users and 62.4% of light users sometimes, frequently or always space shift using Napster.)⁶⁸

C. Napster Provides an Online Community

78. Napster also offers a forum that creates a "community" of listeners with similar tastes and interests. Napster offers many community-oriented features, several of which have proven to be quite popular with users. The live chat feature built into Napster is a way for users to meet other people and engage in discussions about music and other topics. Napster provides chat rooms for fans of music of virtually every genre imaginable: 70's, 80's, Alternative, Blues, Classical, Country, Funk, Hip Hop, Jazz, Ska, and Techno, just to name a few. Users can also add chat rooms on any topic they choose. Napster also supports a "hot list" of users, which lets you know when a user on your list is logged on.

79. In addition, Napster also provides "instant messaging" capabilities. In the past year, instant messaging services have grown to extraordinary proportions and have become some of the most important and powerful features of online companies, evidenced by the ongoing battles between AOL, Microsoft and Yahoo!.⁶⁹ This rise in online communication underscores the increasing value users place on the ability of the Internet to foster communities.⁷⁰

80. A number of websites have recently been created to capitalize on this desire to feel a sense of community. A New York Times article reports that "services that offer Internet users the ability to create their own online communities are cropping up all over

⁶⁷ Ibid., questions #15 and #17.

⁶⁸ Ibid., questions #13 and #15.

⁶⁹ See Hansell, Saul, "In Cyberspace, Rivals Skirmish for Control Over Messaging," The New York Times, July 24, 1999. <http://www.nytimes.com>; and Hansell, Saul, "A Showdown on Messaging May Unite Web Users," The New York Times, August 2, 1999. <http://www.nytimes.com>.

⁷⁰ See Thomas, Susan G., "Hopelessly Devoted to Instant Messages," U.S. News Online, August 9, 1999. <http://www.usnews.com/usnews/issue/990809/nycu/instant.htm>; and Greenman, Catherine, "From Yakety-Yak to Clackety-Clack," The New York Times, November 5, 1999. <http://www.nytimes.com>.

the Web. The trend seems to have begun in earnest in August [1998], when rivals Yahoo and Excite launched, respectively, areas called 'Clubs' and 'Community' that encourage users to form special interest groups around topics ranging from stamp collecting to single parenting Excite claims more than 8,000 communities have been created on its service. Scott Derringer, Excite's product manager for the communities area, calls the notion of communities the 'killer app' of the Web."⁷¹ In a discussion of new business models for the music industry, Webnoize Research suggests that users place substantial value on the community features provided by Napster (and other music-oriented sites).⁷² It is my assessment that Napster's chat, instant messaging, and bulletin board features offer music fans a valuable forum for communication

81. Napster's community features are popular with its users, according to my survey results. For 25.6% of Napster users, community-related features such as chat rooms and instant messaging are somewhat, very or extremely important in their decision to choose a program or website from which to download digital music files.⁷³ Chat rooms have been used by 14.3% of Napster users while 10.3% have sent instant messages to other Napster users.⁷⁴ Of chat room users, 41.5% have increased CD purchases since using Napster while 10.9% have decreased. Among instant messaging users, Napster's impact on CD sales is similar with 40.6% reporting a positive impact and 11.5% a negative impact. The consumers that use community features are more likely to have experienced, on net, increases in CD sales since using Napster.⁷⁵ When asked to select reasons they value Napster, 13.4% of Napster users said they valued meeting individuals with similar music interests.⁷⁶

⁷¹ Napoli, Lisa, "The Latest Internet Buzzword: Community," The New York Times, December 6, 1998. <http://www.nytimes.com>.

See Calem, Robert, "Online Communities Build Net Neighborhoods," The New York Times, June 1, 1997. <http://www.nytimes.com>

⁷² Webnoize Research, "Napster University: From File Swapping to the Future of Entertainment Commerce," Spring 2000, p. 10.

⁷³ Fader Study, question #9.

⁷⁴ Ibid., question #16.

⁷⁵ Ibid., questions #16 and #17.

⁷⁶ Ibid., question #20.

D. Napster is a Platform for Emerging and Independent Artists

82. In part through these community features, Napster offers a platform for emerging and independent artists to reach new audiences. Many such artists, recognizing the tremendous promotional value that Napster offers, have been using the software to create awareness of and interest in their work. Since at least October 1999, Napster has been devoting resources to developing ways for artists to promote their music through Napster.⁷⁷

83. In April 2000, Napster added a searchable database to its New Artist Program. The New Artist Program is a place "where aspiring musicians and their fans can find and share new music with one another."⁷⁸ Through this program, new and independent artists can create a profile identifying their genre of music, hometown, along with listing similar artists and influences to help prospective fans locate them. Artists can also provide information on upcoming shows and links to other websites with more information or music and merchandise for sale. In its next version, Napster will allow the new artist directory to be accessed directly from the Napster service. Napster users will also be able to search for artists by zipcode, lists of most popular artists and lists of most recently submitted profiles.⁷⁹

84. Napster has already had thousands of artists register for this service. Since April it has received 23,000 profiles and approved and entered more than 17,000.⁸⁰ These artists are embracing software platforms, such as Napster, that allow for widespread promotion of their music. Such platforms allow independent artists to widely advertise their music at very low cost. Says one independent artist, "I'd want everybody to download it [my songs], and hopefully, someone would notice me. Then I could get on a record label."⁸¹ Note that this quote predates the original release of Napster. The

⁷⁷ Declaration of Scott Kraus, July 3, 2000.

⁷⁸ Napster web site. <http://artist.napster.com>

⁷⁹ Declaration of Scott Kraus, July 3, 2000.

⁸⁰ Declaration of Scott Kraus, July 3, 2000.

⁸¹ Mui, Ylan, "Sound Business Compressed Audio File Format Called MP3 Could Revolutionize The Music Industry." The New Orleans Times-Picayune, March 25, 1999, page E1.

feasibility (and commercial implications) of achieving such a goal has been greatly enhanced by the rapid growth of the Napster user base.

85. I find substantial evidence in my study that Napster users employ the program to learn about new songs and new artists. Further, such exposure appears to be associated with increased music purchases. Of all Napster users in my survey, 46.2% have used the program to learn about new songs and artists while 9.7% have learned about the local artist community.⁸² Learning about new songs and artists also appears to be associated with increased CD purchases as 39.4% of these respondents have increased CD purchases since using Napster compared to 7.7% decreasing. Of consumers who use Napster to learn about the local artist community, 52.9% have purchased more CDs since using Napster while only 5.8% have purchased less.⁸³

E. Napster Facilitates Exchange of Valuable Promotional Materials

86. Even well-established artists are aided by Napster, which facilitates the distribution of authorized files such as live recordings or "bootlegs." Phish, the Grateful Dead, Pearl Jam and Metallica are just a few of many bands that have authorized the taping and distribution of their live concerts. Napster has gained support from big-name acts such as The Offspring, Chuck D, and the Beastie Boys. They recognize the promotional value the exchange of such recordings generates. Metallica's Lars Ulrich testified in a deposition given in conjunction with this litigation that he made a statement in an online chat held May 2, 2000 that "we [Metallica] have always and will always condone allowing people to record our concerts, to freely trade live concerts." He testified further that he is aware that bootlegged Metallica songs are traded via Napster and that Metallica has chosen "to not object to that."⁸⁴

87. As a recent report noted, "So much music - especially B-sides and live performances - remains underexploited by labels. These labels could create formidable grassroots marketing campaigns using material that does not necessarily stand to eat into

⁸² Fader Study, question #16.

⁸³ Ibid., questions #16 and #17.

⁸⁴ Deposition of Lars Ulrich, June 21, 2000, pp. 32 - 33.

their market share.”⁸⁵ The exchanges facilitated by Napster do just this. In years past, individuals created networks of tape-trading clubs where live recordings captured on cassette tapes were exchanged all over the world through the mail. By providing greater access for fans to a variety of music from their favorite artists, including live recordings, Napster acts as a more efficient network while creating the same kind of promotional value that artists enjoy from radio and television exposure.

F. Napster Incorporates Software to Play and Organize MP3 Files

88. Napster is also designed to provide other functions of value to consumers. The software incorporates an internal player that allows users to play their MP3 files on their computer, organize them, create playlists, and perform many of the other functions that are associated with other leading MP3 software packages such as AOL’s Winamp. Napster’s player is an important feature because it allows users to customize the way they listen to music, through the same software that they sample new music. Users are no longer forced to rely on an external player such as Winamp or Windows Media Player. Rather, they are offered the same features in one convenient package. Napster also allows downloading and sampling to occur simultaneously. Users can listen to songs as they download and cancel the download if they don’t like what they hear. Three quarters (75.4%) of all Napster users in my survey have used the software to play MP3 files while 44.8% have created a playlist and 33% have organized their MP3 files.⁸⁶

G. Napster Introduces Technology with Non-Music Applications

89. The innovative technology used to create Napster also offers a number of non-music-related opportunities. Fortune magazine recently featured Napster on its cover as “The Hot Idea of the Year” because of the possibilities it opens up for peer-to-peer file sharing. Andy Grove, chairman of Intel, marvels that “the whole Internet could be re-architected by Napster-like technology.”⁸⁷ As Mr. Grove suggests, Napster’s capabilities and current uses extend far beyond the ability to share, play, and learn about MP3 and

⁸⁵ Jupiter Communications, “Music Industry and the Internet,” July 1999, p. 1.

⁸⁶ Fader Study, question #16.

⁸⁷ Kover, Amy, “Napster: The Hot Idea of the Year,” Fortune, p. 128, June 26, 2000.

WMA music files from other individuals. The Fortune article discusses at length the broader users of "peer-to-peer technology."⁸⁸

90. As but one example, a researcher involved in the Human Genome Project is investigating ways to use Napster-type protocols to allow scientists, particularly at smaller, independent labs, to share the terabytes of information being created relating to discoveries of the genome.⁸⁹ Some commentators have even gone so far as to say that Napster-like technology has the potential to change the entire Internet model by diminishing the importance of centralized marketplaces such as mp3.com, eBay.com and Amazon.com.⁹⁰

H. Summary of Evidence on Uses

91. When one looks beyond the rhetoric of the plaintiffs, who argue that Napster is "far more insidious than a typical pirate MP3 site,"⁹¹ a closer assessment of Napster's many current and potential uses reveals a technology that has much to offer consumers, record labels, performing artists, and those outside of the music industry.

92. In summary, the evidence supports my view that users participate in, and value, many of Napster's features. Many users consider downloaded MP3 files to be a complement to, rather than a substitute for, CDs. A large percentage of users utilize Napster to make more informed CD purchase decisions, and many translate this sampling feature into increased music purchases. Users employ MP3 files shared through Napster as a way of listening to songs they already own in another format. Users participate in Napster's chatrooms and take advantage of its messaging feature to communicate with other users. By participating in a growing online community that brings together music fans with similar interests from all over the world, users are able to discover new artists

⁸⁸ Ibid.

⁸⁹ Philipkoski, Kristen, "Gene Research, Meet Napster," Wired News, April 5, 2000. <http://www.wirednews.com/news/technology/0,1282,35404,00.html>. Dr. Lincoln Stein and his colleagues at Cold Spring Harbor Laboratory, are developing databases, data-analysis tools, and user interfaces to organize, manage, and visualize the information explosion of the Human Genome Project. http://www.cshl.org/gradschool/stein_.html.

⁹⁰ Burnham, Bill, "Napster: The End of eBay?" ZDNet Music, May 8, 2000. http://music.zdnet.com/misc/opinion/2000_05_08_nap.html.

and whole new genres of music. Independent artists have been given a platform by which they can easily and inexpensively distribute their music. Fans can also trade authorized bootleg music files. Napster users also value the built-in music player and the ability to organize their MP3 files and create playlists. Further, the technology on which Napster is built offers a multitude of conceived and unforeseen opportunities associated with an efficient information exchange system. From this assessment I conclude that Napster is a platform with many uses other than those that could be construed as displacing CD sales and whose applications currently offer benefits and will continue to do so for the period before trial.

VII. Conclusions

93. I find clear and convincing evidence that Napster's role in stimulating CD sales is much more significant than any role it might play in consumers' use of digital music downloads to displace CD sales. Broad-based sources of market-level and individual-level evidence on CD purchases support this conclusion. Plaintiffs fail to provide any valid evidence to refute this point. This evidence is also consistent with a long list of uses for Napster that can be seen as increasing consumer exposure to, interest in and purchases of music. I believe that benefits will continue to accrue to plaintiffs over the next six months as a result of consumers embracing the use of the Napster file-sharing platform.

⁹¹ A&M Records, Inc., et al. v. Napster., et al. Complaint for Contributory and Vicarious Copyright Infringement, p. 15.

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Peter S. Fader, Ph.D. Dallas, Texas, July 3, 2000

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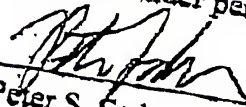
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Peter S. Fader, Ph.D.

Dallas, Texas, July 3, 2000